

Qatar Electricity & Water Company (QEWS)

Recommendation	ACCUMULATE	Risk Rating	R-2
Share Price	QR186.50	Target Price	QR215.00
Implied Upside	15.3%		

Revising Estimates and Maintaining Accumulate Rating

QEWS is a low-risk play deeply linked to Qatar's growth story. We retain our long-term bullish stance on QEWS with an Accumulate rating.

Highlights

- Growing with Qatar:** Buoyed by significant economic and population growth, Qatar's electricity & water demand is set to grow by a CAGR of 8-10% over the next few years. State-backed QEWS (43% ownership + ~11% held by Qatar Petroleum), practically Qatar's sole power & water producer, should benefit from this growth. QEWS owns 62% and 79%, respectively, of the overall power and water desalination capacity of 8,750 MW and 328 MIGD installed in Qatar.
- Watertight contracts ensure visible earnings & cash flows.** Essentially a capacity provider, QEWS buys natural gas (primary feedstock; 67% of cash direct costs, 2012-13) from QP (supplier; 100% government-owned) through long-term take-or-pay contracts and sells power and water to Kahramaa (buyer; 100%) under long-term off-take power & water purchase agreements. Fuel cost hikes are passed through to Kahramaa. These agreements lead to stable margins and any expansion should grow revenue/EPS.
- Updating model and increasing EPS by ~3% in 2016.** Our 2014 EPS increases by circa 5% given 9M results, which while generally in line with our modeled estimates on an operating basis, did benefit from favorable one-time items. We have modestly lowered our 2015 EPS based on higher COGS assumption and increase in finance charges. *More details on Page 2.*
- Stable operating profile and solid dividend yield should pave the way for future earnings acceleration.** Our model shows EBITDA margins remaining at industry highs of 51.2% over 2013-16. We project EPS to grow at a CAGR of 5.9% over 2013-16, including a 15.3% jump in 2016. Dividend payout has remained a solid 53% over 2007-13 and we expect this trend to continue.

Catalysts

- New projects on the horizon:** QEWS should benefit from a new water plant, RAF A2 (36 MIGD), from 2H2015 adding ~14% to QEWS' net water capacity. Further, Facility D (2,400 MW & 130 MIGD; 60% share) should be commissioned in 2017. We also expect contribution from Ras Laffan Industrial Water (recently upped to 65 MIGD from 36 MIGD; 60%) later in 2017. The latter two projects are not factored into our estimates/fair value. Overall, these three projects should expand QEWS' net electricity & water capacity by 27% and 59%, respectively, in 2018. QEWS is seeking regional expansion and has set up a \$1bn JV (60% stake), Nebras Power, with QPI/QH. The partners are valuing QEWS' assets in Oman & Jordon (BV: QR272.6mn) for sale to the JV.

Recommendation, Valuation and Risks

- Recommendation and valuation:** We rate **QEWS an Accumulate with a price target of QR215.00.** The stock trading at a 2014 P/E of 13.8x.
- Risks:** 1) EBITDA margin erosion and 2) International expansion risks.

Key Financial Data and Estimates

	FY2012	FY2013	FY2014e	FY2015e
Revenue (QR mn)	2,838	2,904	2,972	3,033
Revenue Growth	N/A	2.3%	2.4%	2.1%
EPS (QR)	13.02	12.58	13.56	12.96
EPS Growth	10.2%	(3.3%)	7.7%	(4.4%)
P/E (x)	14.3	14.8	13.8	14.4
DPS (QR)	6.64	6.82	7.50	7.75
Dividend Payout (%)	51.0%	54.2%	55.3%	59.8%
Dividend Yield	3.6%	3.7%	4.0%	4.2%
ROE	27.7%	22.6%	21.8%	19.2%

Source: Company data, QNBFS estimates

Key Data

Current Market Price (QR)	186.50
Dividend Yield (%)	4.0
Bloomberg Ticker	QEWS QD
ADR/GDR Ticker	N/A
Reuters Ticker	QEWC.QA
ISIN	QA0006929812
Sector*	Industrials
52wk High/52wk Low (QR)	208.70/142.55
3-m Average Volume ('000)	99.8
Mkt. Cap. (\$ bn/QR bn)	5.6/20.5
Shares Outstanding (mn)	110.0
FO Limit* (%)	25.0
Current FO* (%)	9.7
1-Year Total Return (%)	34.1
Fiscal Year End	December 31

Source: Bloomberg (as of October 29, 2014), *Qatar Exchange (as of October 29, 2014); Note: FO is foreign ownership

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Revising Estimates

Updating model and revising EPS upward by ~3% in 2016. Our 2014 EPS increases by 5% given 9M results, which while generally in line with our modeled estimates on an operating basis, did benefit from favorable one-time items. We have modestly lowered our 2015 EPS based on increased COGS assumption and higher finance charges.

- **We are modeling an average of roughly 2% top-line growth for 2014 and 2015, followed by a ~11% increase in 2016.** Our revenue estimates are driven by a growth factor related to inflation along with a benefit from the startup of the new water plant in mid-2015. We continue to expect QEWS' satellite stations (183 MW capacity) to go offline by the end of this year. 2016 revenue should show the full impact of RAF A-2.
- **We continue to expect EBITDA margins to show modest compression driven by higher costs and lower tariffs for new plants.** For FY2014, we expect an EBITDA margin of 51.1% vs. 53.0% in 2013. Our previous EBITDA margin estimate for 2014 was 51.6%. Beyond 2014, we expect margin erosion of 50bps per annum.
- **Our net income growth is around 8% for 2014.** The dip in earnings next year is partly due to higher finance expenses and partly due to our assumption of higher direct costs. We have modeled an increase in leverage and finance charges as QEWS could look to take on additional debt by year-end 2014 to finance its remaining investment in Nebras Power. Lift in revenue aids 2016 net income growth of ~15%..
- **We keep our dividend estimates unchanged.** We are expecting QR7.50 and QR7.75 in 2014 and 2015 DPS, respectively. DPS is expected to grow about 10% in 2014.

Major Estimate Changes

In QR mn	2014e			2015e			2016e		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
Revenue	2,972	2,960	0.4	3,033	3,005	0.9	3,367	3,209	4.9
EBITDA	1,519	1,526	(0.5)	1,535	1,534	0.0	1,687	1,622	4.0
EBITDA Margin (%)	51.1	51.6		50.6	51.1		50.1	50.6	
Net Income	1,491	1,418	5.2	1,425	1,452	(1.9)	1,644	1,590	3.4
Net Margin (%)	50.2	47.9		47.0	48.3		48.8	49.5	
EPS (QR)	13.56	12.89	5.2	12.96	13.20	(1.9)	14.94	14.45	3.4
Dividend/Share (QR)	7.50	7.50	0.0	7.75	7.75	0.0	8.00	8.00	0.0
Dividend Yield (%)	4.0	4.0		4.1	4.1		4.2	4.2	

Source: Company data, QNBFS estimates

September 2014 Quarter Review

Generally in-line 3Q2014 results with net income beat driven by one-off income. Reported net income for the quarter came in at QR454.0mn (+9% QoQ and YoY), 11.0% above our estimate (QR409.2mn). However, the company benefited from around QR55mn in an one-off settlement-related income received from Kahramaa for RAF A1. *Excluding this, net income would have come in around QR399mn or only 2.5% below our estimate.* Reported revenue of QR812.1mn was only 1.3% lower than our estimate of QR823.1mn (+4% QoQ, +1% YoY). Reported revenue was comprised of: (1) QR456.4mn in electricity revenue (+6% QoQ, flattish YoY), which was just ~1% below our estimate; (2) QR309.7mn in water desalination sales (+3% QoQ and YoY) was around 2% below our estimate; and (3) QR46.0mn in lease income (-5% QoQ, -4% YoY) was also slightly lower than our modeled expectation. EBITDA came in at QR434.5mn (+6% QoQ, -3% YoY) increasing the EBITDA margin to 53.5% vs. 52.7% in 2Q2014 (55.4% in 3Q2013). Finally, share of profits from JVs (Q Power, Mesaieed Power & RGPC) was QR105.9mn (+3% QoQ, -8% YoY) which around 2% below our estimate.

Detailed Financial Statements

Income Statement (In QR mn)	FY2013	FY2014e	FY2015e	FY2016e
Revenue	2,904	2,972	3,033	3,367
Cost of Sales, Excluding Depreciation	(1,148)	(1,245)	(1,286)	(1,444)
Gross Profit	1,756	1,727	1,747	1,923
General & Administrative Expenses	(216)	(208)	(212)	(236)
EBITDA	1,540	1,519	1,535	1,687
Deferred Income	7	7	7	0
Depreciation & Amortization	(458)	(460)	(495)	(517)
EBIT	1,089	1,065	1,046	1,170
Finance Costs	(178)	(111)	(129)	(117)
Interest Income, Dividend Income & Gain on Sale of AFS	92	41	39	40
Other & Miscellaneous Income/Expense & Share of Profits from JVs	389	514	435	458
Share of Associates	19	16	68	132
Profit Before Tax	1,412	1,526	1,459	1,682
Income Tax Expense	0	0	0	0
Profit After Tax	1,412	1,526	1,459	1,682
Minority Interest	(27)	(35)	(34)	(39)
Profit for Shareholders	1,384	1,491	1,425	1,644
EPS (QR)	12.58	13.56	12.96	14.94

Source: Company data, QNBFS estimates

Balance Sheet (In QR mn)	FY2013	FY2014e	FY2015e	FY2016e
Non-Current Assets				
Property, Plant and Equipment	5,055	5,527	5,724	5,365
Available-for-Sale Investments	454	521	521	521
Finance Lease Receivables	1,775	1,641	1,508	1,374
JV Loans and Investments in JVs	721	2,541	2,430	2,343
Other Non-Current assets	267	469	531	656
Total Non-Current Assets	8,272	10,698	10,713	10,258
Current Assets				
Finance Lease Receivables & Others	168	168	168	168
Inventories	276	198	204	230
Accounts Receivables & Prepayments	585	733	748	830
Cash and Short-Term Deposits	1,726	1,085	1,207	2,011
Total Current Assets	2,754	2,183	2,326	3,238
Total Assets	11,026	12,882	13,040	13,496
Equity				
Equity to the Parent	6,111	6,831	7,431	8,222
Minority Interest	230	237	243	251
Total Equity	6,341	7,067	7,674	8,473
Non-Current Liabilities				
Loans and Borrowings	3,361	4,669	4,202	3,782
Deferred Income	14	7	0	0
Employees' End of Service Benefits	39	44	48	52
Total Non-Current Liabilities	3,414	4,719	4,250	3,834
Current Liabilities				
Accounts Payables & Others	689	638	659	732
Loans and Borrowings	413	300	300	300
Derivatives	169	157	157	157
Total Current Liabilities	1,272	1,095	1,116	1,189
Equity and Liabilities	11,026	12,882	13,040	13,496

Source: Company data, QNBFS estimates

Recommendations

Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price

OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings

Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals

R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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